No. 9007

In the United States Circuit Court of Appeals

For the Ninth Circuit.

BETTY ROGERS,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent,

and

BETTY ROGERS, O. N. BEASLEY, OSCAR LAWLER, JAMES K. BLAKE, Executors of the Estate of Will Rogers, Deceased,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITIONERS' REPLY BRIEF.

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TABLE OF AUTHORITIES CITED.

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An examination of the brief for respondent in the case at bar discloses that respondent is compelled to place emphasis on form rather than substance to sustain his position with regard to the taxing effect of the events which took place in the instant case.

This attitude and emphasis in the interpretation of the federal taxing statutes has been recently condemned by the United States Supreme Court in an unanimous opinion in

the case of *Lyeth v. Hoey*, ... U. S. ...., 59 Sup. Ct. 155, 83 L. Ed. (Adv. Ops.) 176 (December 5, 1938).

In this case the question presented was whether property received by the petitioner from the estate of a decedent in a compromise of his claim as an heir was taxable as income. It appeared that petitioner was the grandson of the decedent who died in 1931, a resident of Massachusetts leaving several heirs, among whom was petitioner. By her will decedent gave certain small legacies to her heirs and bequeathed the residuary estate, amounting to $3,000,000 to an Endowment Trust, the income from which was to be paid to another trust created for certain religious purposes. When the will was offered for probate in Massachusetts objection was made by the heirs on the ground of lack of testamentary capacity and undue influence. Eventually a compromise agreement was entered into by the heirs, legatees, devisees and executors providing that certain distributions from the residuary estate were to be made to the heirs. It was petitioner's distributive share under the compromise agreement valued by the Commissioner at some $141,000 which was the subject of the litigation, the Commissioner contending that this sum constituted income to the petitioner in the year it was received, since the law of Massachusetts provided that the rights of parties receiving property under compromise agreements in will contests were contractual and not testamentary. In holding that the sum thus received by the petitioner did not constitute income but rather a sum received by inheritance within the meaning of the Revenue Act, the Court stated:

> "There is no question that petitioner obtained that portion, upon the value of which he is sought to be taxed, because of his standing as an heir and

> of his claim in that capacity. It does not seem to be questioned that if the contest had been fought to a finish and petitioner had succeeded, the property which he would have received would have been exempt under the federal act. Nor is it questioned that if in any appropriate proceeding, instituted by him as heir, he had recovered judgment for a part of the estate, that part would have been acquired by inheritance within the meaning of the act. *We think that the distinction sought to be made between acquisition through such a judgment and acquisition by a compromise agreement in lieu of such a judgment is too formal to be sound, as it disregards the substance of the statutory exemption.* It does so, because it disregards the heirship which underlay the compromise, the status which commanded that agreement and was recognized by it." (Italics added.)

In the instant case, as in *Lyeth v. Hoey, supra,* the respondent seeks to disregard the substance of the transactions. Respondent regards as important the fact that as the method of relinquishing their equity, Mr. and Mrs. Rogers employed the vehicle of a "Grand Deed" which, as do practically all the grant deeds that are or were ever written, commences by reciting a consideration of "Ten and no/100 dollars" (Resp. Br. pp. 8, 13, 15, 21). Although petitioners are unable to perceive any importance in the fact that the deed makes such a recital, since respondent appears to rest his case in such large measure on this fact, it is believed that it should be pointed out:

First, that it has never before been contended by any of the parties to these proceedings that Mr. and Mrs. Rogers received $10.00 or any other sum of money for this conveyance and respondent himself in computing the alleged deficiency has not reflected the payment of any

such sum; secondly, that in assuming that such sum of money was either paid or received merely from the fact of the recital in the deed attached as an exhibit to the stipulation in this case, respondent is reading into the stipulation, a fact which is not stipulated either by content or inference in the stipulation itself, since the amount of loss agreed upon by the parties in paragraph VIII of the stipulation did not include any cash consideration paid by the deed [Tr. 70].

Reverting to the substance of the transactions in the instant case, it appears that Mr. and Mrs. Rogers purchased the property in question paying a portion of the purchase price in cash and for the remainder thereof assuming an already existing indebtedness and conveying the property under trust deed in favor of the seller. The assumed indebtedness was paid and the indebtedness for which the trust deed was given had become due. Suit had been threatened and rather than suffering foreclosure proceedings, Mr. and Mrs. Rogers relinquished their equity in the property. It was natural that the vehicle of a grant deed should be employed in doing so since by such a deed, title records could be kept more clear and free from doubt. There would be no question under the status of the law as the decisions of the Board of Tax Appeals now stand that had Mr. and Mrs. Rogers allowed foreclosure proceedings to take place, the loss which they suffered would have been an ordinary loss rather than a capital loss. (*Hammel v. Commissioner*, 36 B. T. A. 1331, and other foreclosure cases cited in petitioner's opening brief.)

It is submitted that respondent has not successfully distinguished the situation in the instant case from the cases cited by petitioners in their opening brief, namely,

Hammel v. Commissioner, 36 B. T. A. 1331; *Rust v. Commissioner*, 38 B. T. A. 115, and *Warfield v. Commissioner*, 38 B. T. A. 114. The ground upon which respondent attempts to distinguish these cases is that they involve "involuntary conveyance without a valuable consideration flowing to the taxpayers." Certainly in substance the consideration for such conveyances was exactly the same as the consideration in the instant case, namely, payment of a debt.

It is believed that the same reasoning which the Supreme Court of the United States has applied in the case of *Lyeth v. Hoey*, *supra*, to the effect that if the suit had been prosecuted to judgment the contention of the respondent could not be maintained, should be applicable in the instant case. It is a tenet of the law, so old and so well known as to be a legal maxim, that—"the law neither does nor requires idle acts". (California Civil Code, Section 3532.) Certainly it would have been an idle act for Mr. and Mrs. Rogers to have suffered foreclosure proceedings when all that would have been accomplished by such foreclosure proceedings is exactly what was accomplished in the transactions in the instant case.

Respondent seeks to distinguish cases cited by the petitioners in their opening brief, namely, *Watson v. Commissioner*, 27 B. T. A. 463, and *United States v. Fairbanks*, 95 Fed. (2d) 794 (C. C. A. 9, 1938), merely by stating that no sale or exchange occurred in these cases. Petitioners, of course, cited these cases on the ground that the facts were analogous to the instant case and that the Courts in the cases did decide that no sale or exchange had therein occurred. Petitioners do not feel that the authority of these cases has been satisfactorily disputed

by merely stating the conclusion of the Courts in those cases, namely, that there was not a sale or exchange, without showing why the same conclusion should not be reached in the case at bar. Certainly what happens when bonds are redeemed is that sums of money are paid to the bondholders in return for the surrender and cancellation of the bond instrument which is the evidence of liability of the obligor on the bond in the same fashion as the note is the evidence of liability of the obligor on the note. In other words, the payment of a debt does not give rise to a capital loss.

For the reason, therefore, that the substance of the transactions in the instant case discloses that what actually happened was that the taxpayers relinquished their equity to pay off the debt still due on the purchase of the property and for the additional reason that the United States Supreme Court has recently stated that the substance of a transaction should control its effect for taxing purposes rather than the form and for the additional reason that respondent has failed to distinguish satisfactorily analogous cases in which the loss has been declared by the Courts to be ordinary rather than capital, and for the additional reasons set forth in petitioners' opening brief, petitioners respectfully submit that the decisions of the Board of Tax Appeals should be reversed.

Respectfully submitted,

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